MARKET MINUTE

2021 VOLUME 6: MAY REVIEW

This month's Market Minute reflects the views of Clearstead's Research Team and was composed by Daniel Meges, Managing Director

OVERVIEW

Global equity markets generally traded flat during May. In the U.S., markets digested the highest year-over-year inflation number since September 2008. Bottlenecks in supply chains abound, and, as the U.S. economy further re-opens, companies are scrambling to find workers. Uncertainty is running high regarding whether U.S. inflation is set to remain elevated compared to the pre-COVID levels (typically about 2.5%) or become a temporary phenomenon and begin to recede as we head into the Fall. Outside of the U.S., Chinese markets are grappling with the gradual removal of stimulus, India seems to be passing the peak of its surging COVID cases, and Japan is making final preparations for the Summer Olympics against a backdrop of rising COVID cases and a slow vaccination rollout. Amidst these disparate economic challenges, the U.S. dollar weakened steadily during May and 10-year U.S. Treasury interest rates ended the month at 1.60%—down slightly from the end of April.[1]

DOMESTIC EQUITY *As of May 31, 2021*

U.S. EQUITY MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
DJIA	2.2%	5.1%	13.8%	38.8%
S&P 500	0.7%	6.1%	12.6%	40.3%
Russell 2000	0.2%	2.3%	15.3%	64.5%
Russell 1000 Growth	-1.4%	5.3%	6.3%	39.9%
Russell 1000 Value	2.3%	6.4%	18.4%	44.4%

U.S. equities experienced minimal gains in May with U.S. large caps (S &P 500 +0.7) and mid-caps (Russell Mid-Cap Index 0.8%) largely traded sideways during the month, while U.S. small caps (Russell 2000 Index +0.2%) barely gained ground. Investors rotating out of the small cap space continued for a third consecutive month. From 3/1/21 through 5/31/2021, small caps (Russell 2000) have underperformed large caps (S&P 500) by -7.5%.[1]This rotation is in stark contrast to the six consecutive months prior to 3/1/2021, where U.S. small caps had outperformed large caps for by a cumulative 32.0%.[1] In the large cap space, value stocks (Russell 1000 Value) resumed their outperformance over growth stocks (Russell 1000 Growth) as ongoing fears about inflation continued to weigh on high-growth areas of the market, similar to what markets experienced in February and March.

As the U.S. economy continues to re-open, there are still several key events with the potential to drive markets in the near-term, including corporate earnings growth (very high expectations for Q2 and Q3 earnings), the domestic economic trajectory (recent softness in job creation), inflation (temporary or permanent), potential new stimulus (Biden's $4.2 trillion infrastructure and family support plans), and a myriad of geo-political issues (U.S.-Iran nuclear talks). Each of these events have the potential to spark market volatility given their potentially broad economic implications.

INTERNATIONAL EQUITY *As of May 31, 2021*

INTERNATIONAL EQUITY MARKETS				
Index	1 Month	Quater-To-Date	Year-To-Date	1 Year
MSCI ACWI ex USA	3.1%	6.2%	9.9%	42.8%
MSCI EAFE	3.3%	6.4%	10.1%	38.4%
MSCI Emerging Markets	2.3%	4.9%	7.3%	51.0%
MSCI EAFE Small Cap	2.0%	6.1%	10.9%	45.3%

International markets were positive for the month with developed markets (MSCI EAFE +3.3%) leading emerging markets (MSCI EM Index +2.3%). However, more than one-third of the gains in the non-U.S. developed markets were a result of the weakening U.S. dollar which boosts the returns of foreign stocks in U.S. dollar-terms. Similar to the U.S. equity markets, non-U.S. value stocks generally outperformed non-U.S. growth stocks in May, particularly in emerging markets, and foreign small cap stocks generally lagged their foreign large cap peers.

European equities performed well in May (MSCI Europe +4.2%) as re-openings gathered pace, and Canadian equities (MSCI Canada +5.4%) were boosted by a stronger Canadian Doller (Loonie) and higher energy and commodities prices. In emerging markets, Indian equities (MSCI India +8.7%) surged as COVID cases peaked early in the month and finally began to decline. Meanwhile, despite strong economic growth, Chinese equities lagged many other regions (MSCI China +0.8%) as its markets continue to digest declining fiscal measures, higher input prices, and slowing credit growth.

FIXED INCOME *As of May 31, 2021*

FIXED INCOME MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
BarCap US Aggregate	0.3%	1.1%	-2.3%	-0.4%
BarCap Global Aggregate	0.9%	2.2%	-2.3%	4.5%
BarCap US High Yield	0.3%	1.4%	2.2%	15.0%
JPM Emerging Market Bond	1.1%	3.0%	-1.9%	9.0%
BarCap Muni	0.3%	1.1%	0.8%	4.7%

Interest rates continue to be trading in a narrow range, with the 10-year U.S. Treasury yields moving between 1.50% and 1.75%. Yields 2-years and greater moved lower during the month and the yield curve flattened as investors seemed to wrestle with the possibility that the U.S. economy may be near peak inflation and peak growth.

Overall, risk assets (Investment Grade Corporates, High Yield and Emerging Market Debt) had mixed performance in May as Investment Grade spreads tightened, High Yield spreads widened, and EM Debt spreads were largely unchanged. Investment Grade bonds (BarCap U.S. Corporate +0.8%) outperformed, driven by the declining rates on the long end of the curve—IG Corporates have longer duration than benchmark Barclay's Agg Index or High Yield Corporates. EM Debt, despite spreads remaining steady, also performed well (JPMorgan Emerging Market Debt Index +1.1%) as the U.S. dollar weakened.

CLOSING

The U.S. is on track to approach herd immunity by mid-summer. At the end of May more than 135 million Americans have been fully vaccinated and over 50% of the total population has received at least one vaccine. As result, COVID cases trended lower steadily throughout the month and more states began the full re-opening of their economies. These dynamics have propelled the markets during the first five months of the year, but choppier waters await. Along with potential news of new spending from Washington could be a substantial increase in taxes—particularly corporate and capital gains—and new regulations. Equally, it remains to be seen if the current difficultly in luring workers back to the workplace or the surge in commodity prices and supply-chain bottlenecks persist and spur long lasting pressure to corporate margins. As we embark upon sun-filled summer days expect volatility to remain and trading volumes to lighten-up.

Sources
1 - Bloomberg LP, Clearstead